

**COMMONWEALTH OF MASSACHUSETTS**  
**DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

---

)

Boston Gas Company )

Colonial Gas Company ) D.T.E. 99-76

Essex Gas Company )

---

**REPLY COMMENTS OF**  
**BOSTON GAS COMPANY, COLONIAL GAS COMPANY AND**  
**ESSEX GAS COMPANY**

**I. INTRODUCTION**

Boston Gas Company, Colonial Gas Company and Essex Gas Company (collectively, the "Companies") hereby offer the following reply comments in support of the proposed portfolio-management contract with El Paso Gas Marketing Company ("El Paso") and to respond to claims made by AllEnergy Marketing Company, L.L.C. ("AllEnergy") and the Attorney General of the Commonwealth of Massachusetts (the "Attorney General"). As discussed below, the portfolio-management arrangement will provide significant cost savings to customers consistent with the Companies' continuing obligation to provide customers with least-cost reliable service. Moreover, the outsourcing of the resource portfolio will transfer to the wholesale market the management of capacity resources currently under contract to the Companies, which will foster greater liquidity in the upstream capacity market. Accordingly, the Companies request that the Department approve the portfolio-management contract.

As part of the initial filing in this proceeding, the Companies submitted an Explanatory Statement to provide a comprehensive overview of the request for proposals ("RFP") process and of the portfolio-management arrangement. This Companies will not restate the issues discussed in the Explanatory Statement and will address herein only those arguments that are necessary for a complete and accurate understanding of the Companies' proposed portfolio-management contract, filed with the Department on September 15, 1999.

## **II. RESPONSE TO COMMENTS OF THE ATTORNEY GENERAL**

The Attorney General requests that the Department resolve the following issues after conducting evidentiary hearings: (1) that the portfolio-management proposal chosen by the Companies provides the best price and non-price terms; (2) that the proposed contract will provide net benefits to existing firm ratepayers; (3) that the Department's approval of the contract will not result in inappropriate market power as a result of El Paso's affiliation with the Tennessee Gas Pipeline ("TGP"); and (4) whether the revenues stemming from the contract should be given ratemaking treatment in accordance with the principles adopted by the Department in Interruptible Transportation, D.P.U. 93-141-A (1995). In fact, there is no need for evidentiary hearings in order for the Department to resolve these issues.

With regard to the first two issues raised by the Attorney General, the Companies have demonstrated that the proposed portfolio-management contract represents the best value attainable for customers, and that the capacity-mitigation revenues produced by the contract meet the "net-benefit" test. These issues are discussed below in Section III. Second, the relationship between El Paso and TGP is regulated by the Federal Energy Regulatory Commission, which has promulgated standards of conduct and established other regulatory requirements to monitor that relationship. Accordingly, there is no action that could be taken by the Department to govern that relationship. This issue is discussed below in Section IV. Lastly, the Companies seek no change whatsoever in the Department's ratemaking treatment of costs and revenues associated with upstream capacity. In the Explanatory Statement, the Companies noted only in passing that they seek no different treatment from that historically applied by the Department (Explanatory Statement at 16). The Companies have not suggested a ratemaking change that might require hearings or extensive consideration by the Department. Any reconsideration of the requirements of D.P.U. 93-141-A, is beyond the scope of the approval sought for the portfolio-management contract.

All of the issues raised by the Attorney General have been addressed by the Companies' filing and their responses to information requests propounded by the Department and the Attorney General. As a legal matter, G.L. c. 164, § 94A does not require a public hearing and, as a practical matter, the information provided by the Companies provides overwhelming, unchallenged evidence supporting approval. Where there is uncontroverted evidence that the proposed contract meets the Department's standards for approval of a gas resource contract, no evidentiary hearings are warranted.

## **III. THE PORTFOLIO-MANAGEMENT CONTRACT IS CONSISTENT WITH THE COMPANIES' OBLIGATION TO PROVIDE LEAST-COST RELIABLE SERVICE.**

### **A. Background**

On February 1, 1999, the Department of Telecommunications and Energy (the "Department") issued an order in its generic gas-unbundling

proceeding that resolved several key issues related to the service obligations of local distribution companies ("LDCs") and the process for assigning capacity resources to migrating customers and their suppliers. Gas Unbundling, D.T.E. 98-32-B at 4-9 (1999) ("D.T.E. 98-32-B"). Specifically, the Department determined that, until a workably competitive upstream-capacity market develops, the LDCs will continue to have the obligation to provide customers with safe, reliable and least-cost service. D.T.E. 98-32-B at 58-59. The Department further stated that, in order to meet this service obligation, the LDCs must continue to plan for and procure the necessary upstream capacity to serve all firm customers for at least the next three years. Id. at 40-41.

Because the responsibility to plan for and procure capacity on behalf of customers comes with the obligation to provide least-cost service, the Companies must continually seek ways in which to optimize the value of their gas-supply resources and to minimize the cost of those resources for customers. Over the past five years, the Companies, on an individual basis, have achieved value for their gas-supply resources through a series of short-term asset-management arrangements of limited scope and duration. In the Companies' experience, these arrangements provided mitigation revenues that could not otherwise be achieved because the asset manager is in a better position to identify and capitalize on marketing opportunities. As a result of this experience, and through their involvement in the Massachusetts Gas Unbundling Collaborative (the "Collaborative"), the Companies have come to recognize that greater savings could be attained for customers where the capacity-resource portfolio is managed by a wholesale marketer and: (1) the wholesale marketer has discretion over the use of the resources; (2) the contract term is multi-year; and (3) the wholesale marketer is provided with a versatile and substantial set of resources. Significantly, the Department endorsed the concept of a longer-term portfolio-management arrangement finding that it "is a mechanism suited to provide all Massachusetts gas customers with reliable, safe and least-cost service." Id. at 54.

This backdrop played an important role in the Companies' evaluation of gas-supply synergies that would result from the mergers. As part of their merger-integration strategy, the Companies combined their resource portfolios and have worked diligently to enhance the efficiency, and lower the cost, of the combined portfolio through contract negotiations with Tennessee Gas Pipeline Company, the Algonquin Gas Transmission Company and other pipelines on which the Companies hold capacity. In addition, based on their previous experience with limited-term asset-management arrangements, the Companies recognized that the outsourcing of the combined portfolio to a wholesale marketer would generate substantial value. These initiatives will produce substantial cost reductions for customers, which is precisely the result that the Department

envisioned in approving the mergers and associated rate plans. Eastern-Essex Acquisition, D.T.E. 98-27, at 26-30 (1998); Eastern-Colonial Acquisition, D.T.E. 98-128, at 71-74 (1999).

B. Consistency With Department Standards

The Department must make two primary determinations in this case: (1) that the El Paso proposal, as the product of a "fair, open and transparent" competitive bidding process, will provide the highest possible value to customers (see D.T.E. 98-32-B at 55); and (2) that the proposed portfolio-management contract will provide net benefits to existing firm customers. As discussed below, the Companies' proposed portfolio-management contract meets these standards, and therefore, should be approved by the Department.

With regard to the first standard, the record shows that the El Paso proposal is the product of a balanced, vigorous competitive bidding process (Explanatory Statement at 2-9). The Companies conducted a request for proposals ("RFP") process designed to solicit bids from a broad range of wholesale marketers and to ensure that those bidders had the benefit of a level playing field. In addition, because the RFP required each bidder to offer city-gate sales service using the same commodity price indices, the Companies were able to make direct comparisons between the bids based on the amount of the capacity-management fee (id. at 4, 10-11). The record shows that the El Paso proposal will produce capacity-mitigation revenues in excess of those offered by competing proposals, including the proposed alternatives. See Confidential Responses to Information Requests AG 1-2, AG 1-3, AG 1-4, AG 1-5 and AG 2-4.

With regard to the second standard, the record shows that the El Paso proposal will produce capacity-mitigation revenues in excess of those that would be achieved by the Companies. See, Explanatory Statement at 12-16; Attachment D (Tab 2.D of Initial Filing) [confidential]; Responses to Information Requests DTE 1-2 and AG 3-6. The record shows that, as a result of the recent consolidation of the supply portfolios and the contract-restructuring negotiations stemming from that consolidation, the Companies have reduced the overall amount of capacity associated with the portfolio. See, Attachment D (Tab 2.D of Initial Filing) (confidential); Response to Information Requests AG 3-4 and AG 3-5. This fact is significant because the changes made to the portfolio since the last heating season would tend to reduce mitigation opportunities associated with the resource portfolio (Explanatory Statement at 13-14). Notwithstanding the reduced levels of capacity, the proposed contract with El Paso will produce net benefits to customers when compared to previous capacity-mitigation revenues. Therefore, because the proposed portfolio-management contract meets the Department's two-prong test, the contract should be approved for commencement on November 1, 1999.

C. Consistency with D.T.E. 98-32-B Directives

In conducting the RFP process, the Companies considered the directives set forth by the Department in D.T.E. 98-32-B. Although the arrangement entered into by the Companies

differs from the portfolio-auction approach proposed in that proceeding by eight local distribution companies, the Department's findings on that proposal provided significant guidance to the Companies. With regard to process, the Department stated that each LDC should: (1) make its own decision whether to outsource the portfolio (D.T.E. 98-32-B at 55); (2) conduct a "fair, open and transparent" process (id.); (3) keep adequate records to document results and savings (id.); (4) negotiate with the bidder all contractual components such as term, default service, administrative fees (id. at 57); (5) provide the terms of any proposed "portfolio auction" to the Department in advance (id.); (6) provide the Department with a copy of the RFP (id.); and (7) file with the Department a description of its outsourced upstream capacity-management program (id.). The record indicates that the Companies have complied with each and every requirement set forth by the Department (Explanatory Statement at 2-9).

AllEnergy's complaint that the Companies' RFP process "failed to comply" with the Department's Order is erroneous. AllEnergy does not dispute the Companies compliance with the above-listed process requirements. AllEnergy's dispute is that the Companies failed to comply with the Department's "suggestion" that the Collaborative develop standards concerning wholesale and retail marketers participation in the market area in connection with the portfolio auction (AllEnergy Comments at 1-2, citing D.T.E. 98-32-B at 56). In fact, the Department did not require that such standards be developed, nor did the Department indicate that such standards had to be developed by the Collaborative before an individual LDC could pursue an outsourcing arrangement. Moreover, the Department expressly stated that an LDC that pursues this course of action should "hedge against the potential for abuse by evaluating the portfolio manager's conduct during the term of the LDC's portfolio management contract. . . ." D.T.E. 98-32-B at 56-57. As discussed below, the Companies have considered and resolved issues concerning the effect of the outsourcing arrangement on the development of retail competition through the contracting process, as contemplated by the Department. See, Response to Information Requests DTE 1-4, DTE 1-5, DTE 2-6, DTE 2-8, DTE 2-9, DTE 2-10, and DTE 2-15.

The Companies have demonstrated that they have conducted a fair, open and transparent RFP process and that the proposal put forth by El Paso represents that maximum value for customers as established by that competitive bidding process. Moreover, the value received from El Paso will provide customers with capacity-mitigation revenues in excess of those achieved by the Companies prior to the arrangement, notwithstanding the fact that the Companies' historical mitigation revenues were based on a greater amount of available capacity. Accordingly, the proposed portfolio-management contract should be approved.

#### **IV. THE PORTFOLIO-MANAGEMENT CONTRACT WILL NOT POSE A BARRIER TO THE DEVELOPMENT OF RETAIL COMPETITION IN MASSACHUSETTS.**

In endorsing the portfolio-outsourcing concept, the Department acknowledged concerns regarding the effect of such an arrangement on the development of retail competition in

Massachusetts. D.T.E. 98-32-B at 56. Although in this proceeding AllEnergy and the Attorney General have cast these concerns in terms of "market power," the concern actually relates to the potential for market abuse stemming from an affiliate relationship, such as: (1) between a pipeline company and a wholesale marketer; or (2) between the wholesale marketer and a retail marketing affiliate. In this case, standards of conduct established by the Federal Energy Regulatory Commission apply to the relationship between the Tennessee Gas Pipeline Company and El Paso, and there is no retail marketing entity affiliated with El Paso. See, Response to Information Request DTE 1-4.

In commenting on the portfolio-auction proposal in D.T.E. 98-32-B, a group of retail marketers, including AllEnergy, stated that portfolio-management plans may pose a barrier to the development of the competitive market in two primary respects: (1) such arrangements tend to lower the price of LDC sales service, and therefore, make it more difficult for retail marketers to undercut the LDC's prices; and (2) the wholesale marketer who acts as portfolio manager may exert "market power" so as to advantage their affiliate to the detriment of other market participants. D.T.E. 98-32-B, Marketer Group Comments at 10; Marketer Group Final Comments at 53-54. Accordingly, the marketers stated that, were this type of arrangement entered into, "appropriate affiliate rules [would] need to be in place between the wholesale marketer and the LDC's affiliates and between the wholesale marketer and their own affiliates in order to address [the] market power issue." D.T.E. 98-32-B, Tr. 4, at 130 [Bachelder]; Marketer Group Final Comments at 54.

The record demonstrates that, in this case, the marketers concerns have been considered and addressed through the RFP and contracting process. First, in structuring the RFP, the Companies determined that they would maintain all control and administration of their capacity-assignment programs (Initial Filing, Tab 2.A, § 4.1). This, in effect, would remove the portfolio-manager from any potential conflicts of interest that could arise in assigning capacity on behalf of migrating customers to retail marketers. Second, recognizing the concerns raised in D.T.E. 98-32-B with regard to the potential for affiliate abuses, the Companies explicitly required bidders to address the issue of potential conflicts of interest in their proposals submitted in response to the RFP (Initial Filing of the Companies at Tab 2.B (page 10)). The Companies planned to address and resolve any issues regarding affiliate relationships through the contract-negotiation process with the final candidate, rather than prescribing a certain resolution in the RFP, which may have had the unintended affect of changing a proposal's value.

Once El Paso's bid was determined to represent the highest value, this issue became moot because El Paso has no affiliation with a retail gas-marketing entity. See Response to Information Request DTE 1-4. El Paso does not sell directly to commercial, industrial or residential customers located behind the city gate of any local distribution company (id.). Moreover, although El Paso is affiliated with an interstate pipeline (TGP), TGP is regulated by the Federal Energy Regulatory Commission, which has promulgated standards of conduct to govern the relationship between TGP and its unregulated affiliates. See 18 C.F.R. §§ 161.1, 161.2 and 161.3. As a result, the Companies' arrangement with El Paso will have no impact on retail marketers operating on the

Companies' system in that El Paso will have no involvement with the Companies' transportation programs or with retail marketing efforts.

AllEnergy contends that the structure of the RFP concentrates over 50 percent of Massachusetts capacity, including both upstream and downstream capacity, in the hands of a single wholesale marketer raising "serious market power concerns." This claim is faulty in several respects. First, AllEnergy states that the asset-management RFP advanced by the Companies will "increase the concentration of control over pipeline capacity contracts" because a portfolio of capacity that until recently was controlled by three separate entities will now be placed in the hands of one entity. Significantly, the three portfolios have been consolidated as a result of the recent mergers, and not because of the portfolio-management arrangement. The Companies are transferring to El Paso only the right to manage a set of resources that are controlled by the Companies as a single, integrated resource portfolio. Similarly, AllEnergy's claim that approval of the portfolio arrangement will likely lead to "fewer holders of capacity" is in error, because the Companies will continue to hold and control the capacity resources necessary to meet the requirements of sales service customers consistent with the Department's directives in D.T.E. 98-32-B. Thus, there will be no fewer, and no more, holders of this capacity as a result of the portfolio-management arrangement. El Paso is receiving nothing more than the right to manage the resources not needed for assignment to migrating customers for a three-year period consistent with the terms and conditions of the Companies' resource contracts.

With regard to its claims of "market concentration," it is significant that AllEnergy provides no explanation, guidance or theory as to the way in which this "market concentration" will pose a barrier to the development of retail competition or what the "serious market power concerns" may be. To the extent that AllEnergy is asserting that the portfolio-management arrangement will affect the retail marketers' resource alternatives for supplying customers in Massachusetts, the relevant analysis is not what percentage of capacity El Paso will manage in relation to capacity held by other LDCs, but rather, what the Companies' capacity resources are in relation to the spectrum of transportation alternatives available to retail marketers, or total deliverability into the region. Consideration must be given to the transportation alternatives available to marketers because marketers use capacity resources from other New England states to serve customers in Massachusetts. In that regard, the Companies' resource portfolio represents only 14 percent of the total capacity serving this region. See Response to Information Request AG 1-9.

AllEnergy further argues that the Department should refrain from approving a portfolio-management arrangement until "market power" issues are resolved and that, like default service in the electric industry, the Department should require "multiple winners" in this case. However, the Department has already determined in D.T.E. 98-32-B that the Companies must maintain their traditional obligation to serve for the transition period. The portfolio-management arrangement does not represent a fundamental change in the structure of the Companies' gas sales service. In fact, the portfolio-management arrangement is nothing more than a mechanism to enhance the level of mitigation

revenues achieved by the Companies for the use of its gas-supply resources. Given that the three-year term of the contract is consistent with the Department's transition period, approval of the contract neither creates a new market structure, nor precludes the development of retail competition.

## **V. CONCLUSION**

As discussed above, the portfolio-management arrangement will provide significant benefits to customers consistent with the Companies' continuing obligation to provide customers with least-cost reliable service. Moreover, the outsourcing of the resource portfolio will transfer to the wholesale market the management of capacity resources currently under contract to the Companies, which will ultimately foster liquidity in the upstream capacity market. Because the portfolio-management arrangement with El Paso, as the product of a competitive bidding process, represents that highest possible value and results in net benefits to customers, the Companies request that the Department approve the contract for commencement on November 1, 1999.

Respectfully submitted,

**BOSTON GAS COMPANY**

**COLONIAL GAS COMPANY**

**ESSEX GAS COMPANY**

By their attorney,

---

Cheryl M. Kimball, Esq.

Keegan, Werlin & Pabian, LLP

21 Custom House Street

Boston, MA 02110

(617) 951-1400

Dated: October 1, 1999